Current legal problems related to commercial property

The Czech commercial property market undergoes currently a booming period, although it has to live with some legal ambushes. By **Pavla Prikrylova Attorney at Law Partner, Peterka & Partners, Czech Republic**

Real estate in the Czech and Slovak Republics constantly represents an interesting investment opportunity for foreign investors. Even though profitability has of late slightly decreased, it is expected that the real estate market will remain attractive in the future.

Acquisitions of administrative buildings continue to hold the leading position in both countries. In recent times, there has also been an increasing interest in investment in commercial centres, often outside the capital cities, since commercial centres can bring home higher profits than administrative complexes. The same applies to industry-oriented real estate (logistic centres and warehouses). A general observation can be made which shows that greenfield sites are sought after more than brownfield sites since, in the development of already existing buildings, investors must often deal with unsatisfactory technical parameters, various burdens on the environment and obscure ownership relations.

The purpose of this article is to highlight a number of legal problems which investors typically encounter, and to stress certain peculiarities of Czech and Slovak legislation which regulates this area. Generally, it can be noted that the Czech and Slovak legislation applicable in the branch of real estate does not conform to the standards of more developed real estate markets and the areas calling for the most urgent need of change are those of non-residential premises leases and in the Czech Republic the real estate cadastre. On the other hand, this legislation also contains certain advantages in comparison with the legislation of most EU member states, e.g. the advantages of Slovak tax legislation (viz. there is no tax levied on transfers of real estate).

Lease of non-residential premises: unsatisfactory legal regulation

Unlike what is common in most EU member states, in the Czech and Slovak Republics a lease of premises for commercial purposes is governed by two different statutes: the Civil Code, which stipulates the conditions for leases in general, and the Act on the Lease and Sub-Lease of Non-Residential Premises (the "Act"), which deals in particular with commercial premises. However, one of the consequences of this twofold system is that different legal regimes apply depending on whether a building is leased as a whole or whether only certain commercial premises (i.e. a part of a building) are leased.

According to present wording of the Act, a lease contract has to fulfill a number of requirements, otherwise it is considered null and void. Even though the previously required approval of the competent municipal authority for the conclusion of a contract on the lease of retail&wholesale premises was abolished (in 1999 in the Czech Republic and in 2004 in Slovakia), the parties are still hindered by rather restrictive legal rules.

Thus, a contract must be concluded in writing, must stipulate the object of lease, the purpose of the lease and precise conditions related to the payment of rent (amount, due date, payment method) etc. On the other hand, when a lease of a building as a whole is concerned and the Civil Code is applicable, none of the above-mentioned elements are obligatory.

Concerning the termination of a lease contract concluded for a definite period of time, the parties are bound to only terminate it on the grounds which are listed in the Act and they may not agree on other reasons for termination. Despite the relatively liberal approach of the Czech courts in this matter, the current restrictive character of the legal regulation is not justifiable in this field.

Nonetheless, according to present regulation a lessee is authorized to terminate a lease contract, among others, in the case of a change in the owner of the building. This provision represents a high risk for an investor acquiring a commercial building into its ownership as the lease contracts related to the building influence its value and currently may be terminated immediately after acquisition.

It is clear that the above-mentioned regulations do not correspond any more to the actual needs of the real estate market in practice and therefore an amendment to the Act is now being debated in the Czech Parliament. In the Slovak Republic, modifications of this legal regime are expected in the future.

The said pending amendment could partially resolve these problems in the Czech Republic since it excludes the possibility of the termination of a lease due to a change in the owner of a building, and introduces greater freedom for the parties to agree on the grounds for termination. Nevertheless, it is not clear now whether the amendment will be passed and in what specific wording.

Though, the amendment of the Act cannot solve all difficulties that investors encounter in the field of commercial leases. Among further restraints rank, for instance, the issue of an Occupancy Permit.

In both countries, newly constructed or refurbished premises may not be occupied unless an Occupancy Permit is issued by the competent building authority. The condition of having to acquire an Occupancy Permit currently represents

another obstacle for commercial leases since it does not result clearly from the legislation whether it is possible to conclude a lease contract before the issuance of an Occupancy Permit. Thus, agreements on future lease contracts engaging the parties to conclude a final lease contract after issuance of the Occupancy Permit have become common practice in order to avoid the risk of a lease contract being declared null and void.

Real estate cadastre

In the Czech and Slovak Republics legal relations to real estate are registered by the real estate cadastre and in principle the purchase of most real estate is effective at the moment the new owner is registered in the cadastre.

Nevertheless, such registration cannot be regarded as a guarantee that the transfer has been validly completed and may be objected to at anytime in the future by the real holder of the ownership title to the property.

Consequently, prior to a real estate transaction taking place it is highly recommended to effectuate a due diligence of the ownership titles related to the property that in the Czech Republic are available to the general public at the competent cadastral authorities. Purchase contracts should thus be formulated according to the results of the due diligence in order to minimize the specific risks. Therefore, in the Czech and Slovak Republics, lawyers usually prepare a real estate transaction unlike what is common practice in some other European countries (for instance, in France it is a notaries' business since the contracts are much more simple).

The excessive duration of the registration procedure remains one of the principal problematic issues in the Czech Republic (in Prague the average duration is 4-5 months). In Slovakia, however, time limits of 15 or 30 days have been introduced for such procedures.

Regulation of relations between connected persons

Real estate transactions often use corporate law instruments; real estate is made part of a company's registered capital or is owned by an SPV. Consequently, the shares or a corporate part of that company are transferred (the owner of the property remains unchanged). The possibility to avoid the payment of transfer tax applicable to real estate transfers amounting to 3% is one of the principal reasons for such schema in the Czech Republic.

In this context it is necessary to point out that the Czech Commercial Code regulating relations among companies within a group is quite strict compared to EU directives (and often goes beyond the scope of their requirements). Thus, certain transfers of assets between connected persons (in principle, the company, its shareholders and representatives and companies of the same group) must be approved by company's bodies and realized for a price fixed by a judicial expert. In the case that the respective provisions of the Commercial Code are not respected, the transfer of assets is void and even third parties acting "in bona fide" are not protected in case of this nullity. As far as Slovakia is concerned, similar principles apply, thus the legal regulation is not so strict. ■

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